COUNSEL'S COMMENTS

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PRIOR BOARD APPROVAL OF NEW CONDO RESIDENTS—A POST 9/11 APPROACH

The events of 9/11 and the subsequent May 2002 FBI warnings about terrorist bomb plots have led to increased security in apartment buildings in the New York/New Jersey metropolitan area and across the nation. These measures include greater vigilance by building personnel, enhanced surveillance and alarm systems, identification badges and other precautionary measures. Nevertheless, advance screening of prospective residents by condominium boards seems not to be a widespread practice presumably to a large extent because of concerns about unlawful restraints on alienation under traditional common law real estate doctrines. However, because of the changed times and the increased public policy emphasis on homeland security, it is time to take a harder look at requiring (i) detailed background information from all new owners and tenants and (ii) prior approval of every prospective resident before occupancy is permitted in condominium apartment buildings.

Historically, co-op boards have implemented a screening process whereby they could reject tenant shareholders or their subtenants for financial or lifestyle reasons provided that the Board did not discriminate based upon race, color, religion, sex, national origin, or other categories protected by federal and state constitutions and statutes. Legally, this has been perceived not to constitute an unlawful restraint on alienation because the purchase of shares in a cooperative did not involve the transfer of real estate. Moreover, from a practical standpoint there is a genuine need for protection against liability of other shareholders for mortgage payments and real estate taxes included in the maintenance fees of defaulting shareholders, which is not the case with condominiums.

The law prohibiting unreasonable restraints on the alienation of real property has generally been thought not to apply to cooperatives because only shares of stock in the cooperative corporation were transferred and not title to real estate as in the case of a condominium. This view is clearly a classic case of form over substance, especially in light of the New Jersey Co-operative Recording Act, N.J.S.A. 46:8D-1 et seq. (the "Co-op Recording Act"), adopted in 1987, which recognizes the hybrid nature of a transaction "that is not capable of classification entirely as realty or personality." On the other hand, the conventional wisdom in New Jersey apparently has always been that a condominium board's prior right of approval of residents of condominiums constituted an unlawful restraint on the alienation of real estate because of the stringent view taken by New Jersey courts with respect to restraints on the transfer of real estate in general. (*see Drachenberg v. Drachenberg,* 142 N.J. Eq. 127 (10 N.J. Err. & App. 1948), involving an agreement among tenants in common not to dispose of their interest in two dwellings for an indefinite period of time without their unanimous consent.)

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Arguably, existing statutory and common law would permit both co-ops and condominium associations to amend their governing documents to require prior board approval of potential occupants, at least where the primary purpose is to improve the security of the building. Specifically, the Co-op Recording Act under N.J.S.A. 46:8D-6d and the New Jersey Condominium Act (the "Condo Act"), pursuant to N.J.S.A 46:8B-9(m), provide that a master declaration or a master deed may include "restrictions or limitations upon the use, occupancy, transfer, leasing or other disposition of any unit (provided that any restriction or limitation shall be otherwise permitted by law)." Certainly, both of these provisions would seem to encompass the right of a co-op or condominium board to require background information and advance approval of the occupants of any unit, especially in today's climate.

Perhaps the threshold question that needs to be addressed is whether or not such a screening or prior approval restriction or limitation is permitted by law. Presumably, this means that such provisions are permitted if they are not prohibited and that express statutory or common law authority for such restrictions is not required. Accordingly, and assuming that there are no discriminatory impediments because of constitutional or statutory protections, a reexamination of the more modern cases dealing with partial restraints on alienation in other jurisdictions is relevant to the inquiry.

A more modern trend occurring in many states is that partial restraints in the condominium context are considered valid if the restraint is reasonable. As stated in *City of Oceanside v. McKenna,* 215 Cal. App. 3d 1420 (1989), where the Court upheld a prohibition against renting or leasing a unit in a publicly subsidized condominium community for low and moderate income persons:

> "the traditional rule against restraints on alienation is based on the public policy notion that the free alienability of property fosters economic and commercial development....However, almost from the inception of the rule, competing policy considerations have led to exceptions to the rule, with the validity of the restraint determined on the basis of the duration, type of alienation precluded or the size of the class precluded from taking....The modern view is to test the validity of the restraints by weighing the competing social policies."

The California Court went on to cite an earlier Illinois case, *Gale v. York Center Community Cooperative, Inc.,* 21 Ill. 2d 86 (1960), wherein the Illinois Supreme Court observed:

> "[T]he crucial inquiry should be directed at the utility of the restraint as compared with the injurious consequences that will flow from its enforcement. If accepted social and economic considerations dictate that a partial restraint is reasonably necessary for their fulfillment, such a restraint should be sustained."

In a leading Florida case, *Aquarian Foundation, Inc. v. Sholom House, Inc.,* 448 So. 2d. 1166 (Fla. Dist. Ct. App. 1984), the Court, in voiding a condominium board's denial of consent of the conveyance of a condominium unit, recognized that reasonable restraints could exist. In relying upon

Hidden Harbour Estates, Inc. v. Norman, 309 So. 2d 80 (Fla. Dist. Ct. App. 1975) and other Florida cases, the Aquarian Court stated:

> "it is well settled that increased controls and limitations upon the rights of the unit owners to transfer their property are necessary concomitants of condominium living.... [I]nherent in the condominium concept is the principle that to promote the health, happiness and peace of mind of the majority of the unit owners since they are living in such close proximity and using facilities in common, each unit owner must give up a certain degree of freedom of choice which he might otherwise enjoy in a separate privately owned property. Condominium unit owners comprise a little democratic subsociety of necessity more restrictive as it pertains to the use of condominium property than may be existent outside the condominium organization. Accordingly, restrictions on a unit owner's right to transfer his/her property are recognized as a valid means of insuring the Association's ability to control the composition of the condominium as a whole."

See also *Woodside Village Condominium Assn. Inc. v. Jahren,* 806 So. 2d 452 (Fla. 2002), discussed in an earlier column where the Court stated in upholding limits on rentals:

> "The attainment of this community goal outweighs the social value of retaining for the individual unit owner the absolutely unqualified right to dispose of his property in any way and for such duration or purpose as he alone so desires."

Although there are no New Jersey cases embracing the concept expressed in the California and Florida courts permitting reasonable limitations on the occupancy of condominium or co-op units, the *Gale* case, *supra,* upholding a restriction against the transfer of membership in a 72-family cooperative residential subdivision, coupled with a right of first refusal and redemption, espoused certain principles which would also seem appropriate for New Jersey in 2002. Specifically, the Court stated:

> "if accepted social and economic considerations dictate that a partial restraint is reasonably necessary for their fulfillment, such a restraint should be sustained....In short, the law of property, like other areas of the law, is not a mathematical science but takes shape at the direction of social and economic forces in an ever changing society, and decisions should be made to turn on these considerations."

In conclusion, I would submit that the events of 9/11 and the increased societal concerns about security clearly outweigh the historical and more stringent view about the repugnancy of restraints

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on alienation of property. Accordingly, in light of the legislative policy in the New Jersey Condo and Co-op Recording Acts permitting restrictions on occupancy or transfer of units, those condos and co-ops which have a serious concern about the security of their complexes and the identity of their neighbors should give serious consideration to the implementation of an advance screening and approval process for new residents, including background checks, if deemed appropriate. Obviously, this should be done in conjunction with their respective counsel, who I hope would share my view that the New Jersey courts would uphold board denials of occupancy based upon valid security concerns as being reasonable partial restraints on the alienation of condo and co-op units in these post 9/11 times. At the very least, a detailed background questionnaire and screening process for all prospective occupants might very well serve as an effective practical deterrent for those who might have terroristic or other criminal motives in mind. ■

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tions are certain to be subject to greater scrutiny. The Division of Taxation has more authority to make adjustments in this area as a result of this legislation.

9. **Minimum Tax Increase**–The minimum tax for corporations has increased from $210 to $500. In the case of taxpayers with payroll of $5 million or more, the minimum tax will be $2,000.

10. **A Lower Graduated Rate**–"C" Corporations that have an entire net income of $50,000 or less will benefit from a new 6.5% rate bracket.

11. **No Deduction for Foreign Taxes**–Taxes paid to foreign countries have been added to the list of taxes that are not deductible for CBT purposes.

12. **Depreciation Decoupling**–The "bonus" 30% depreciation allowed for federal income tax purposes will not be allowed for New Jersey. As a result, corporations will need to keep an additional set of depreciation calculations for New Jersey purposes only.

The above is a brief outline of the changes in the law. Several important details have been omitted for the sake of clarity. It is obvious that these changes will impact a wide variety of business taxpayers.

Since many taxpayers have based quarterly estimated taxes under assumptions that have now changed (such as the suspension of net operating loss carry forwards), you may want to consult with your accountant to determine how these changes affect you. ■